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**THESIS**

**“EVALUATING THE RESPONSIBILITY OF THE STATE AND THE STANDARD OF  
PROOF IN INVESTOR – STATE ARBITRATION CASES INVOLVING CORRUPTION  
ALLEGATIONS”**

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## TABLE OF CONTENTS

<b>Introduction.....</b>	<b>4</b>
<b>Chapter 1: Corruption and International Arbitration.....</b>	<b>6</b>
1.1 Corruption as an increasing concern in international arbitration.....	6
1.2 General information about means of evidence, burden and standard of proof.....	12
<b>Chapter 2: Standard of Proof of Corruption in Investor-State International Arbitration.....</b>	<b>16</b>
2.1 Corruption in investor-state international arbitration.....	19
2.2 Prima facie evidence as a standard of proof.....	21
2.2 Balance of probabilities or preponderance evidence.....	23
2.3 A higher standard of proof.....	25
2.4 The special case on corruption: Circumstantial evidence.....	26
<b>Chapter 3: Evaluating the State Liability.....</b>	<b>31</b>
3.1 Asymmetry in investor-state cases involving corruption allegations.....	34
3.2 State liability in the Chevron v. Ecuador case.....	37
3.3 Approach to the relationship between corruption and the environment.....	44
<b>Conclusions.....</b>	<b>49</b>
<b>Bibliography.....</b>	<b>52</b>

*Gratitud a Dios,  
a mi padre y madre por su constante esfuerzo y dedicación.  
Gratitud a mi profesor guía por su acompañamiento y ayuda.  
Gratitud porque las cosas que cuestan,  
son aquellas que más valen la pena.*

## **Introduction**

The relevance that corruption has gained in law and in international politics has increased notably in recent years. On a global scale, instruments and policies related to these practices have been implemented due to the demands of international commerce, the prevention of international crime, good corporate governance, transparency and responsibility in the public sectors, as well as a better understanding of the effects of corruption on economic development, political stability and the rule of law.

The fight against international corruption arose in the United States at the end of the seventies with the Foreign Corrupt Practices Act of 1977, promoted by the administration of Jimmy Carter (Llamzon, 2014, pp.45, para.4.06). This law sanctioned for the first time a behavior that until then was unpunished, corruption of foreign public officials. Years later, in 1997, the Organization for Economic Co-operation and Development or OECD approved the Anti-Corruption Convention of Foreign Public Agents in International Commercial Transactions. This was followed by many other international conventions, such as the Criminal and Civil Conventions on Corruption of 1999 and the United Nations Convention Against Corruption. As expected, the new order and the importance that corruption has gained are increasingly reflected in the corresponding writings and arguments of the parties in international arbitration, as has occurred in some investment arbitrations.

Corruption has expanded in a generalized manner across all continents and among many institutions, until it has reached international commercial and investment arbitration proceedings. Arbitration is not a new forum for the issues of corruption; arbitrators have effectively and efficiently fought corruption for years.

As will be observed in a comprehensive study of corruption decisions in international investment arbitration, corruption issues arise in foreign investment and also in foreign investment disputes regarding the bilateral investment treaty (BIT), leading to undesirable outcomes. So, it seems that there are some questions that beg a more definitive view, such as, what are the arbitrators to do when allegations of corruption arose? What is the applicable law? Which standard of proof should be applied? Who is responsible? This study endeavors to address these issues that leave arbitral tribunals and national courts in a quandary every time the issue of corruption is alleged.

The main objective of this thesis is to evaluate and determine the liability of states and the standard of proof used by arbitrators in investor-state arbitration cases involving corruption allegations, analyzing some investor-state arbitral cases. This study delineates these controversial concerns and analyzes practical solutions within the context of theory and practice.

In order to accomplish this, different working methodologies will be applied. This thesis is organized in three distinct chapters: chapter 1 analysis the phenomenon of corruption and gives an overview regarding international arbitration and the concept of standard of proof. On chapter 2, the thesis explores the real problem regarding the standard of proof in international arbitration, explaining the different ways evidence should be valued; also, some arbitral cases from the ICSID will help to provide a better overview. Finally, in chapter 3, since the articles on state responsibility for internationally wrongful acts are of high importance, the responsibility of states for this matter will be analyzed and the approach between corruption and the environment will be examined.

## **Chapter 1: Corruption and International Arbitration**

### **1. Corruption as an increasing concern in International Arbitration**

“Despite decades of international efforts against it, corruption continues to present multiple challenges to governments, businesses, academics, and the public” (Ledeneva, 2018, p. 418).

Corruption is called nowadays, the dark side of globalization, it affects economic development, political stability, democracy, fundamental human rights, rule of law and more recently the environment. It affects the sets of values, principles and rules that govern the law in its entirety.

Corruption means different things to different people, “it is a polyvalent word”, “corruption identifies a concept everyone instinctively understands but would find hard to articulate completely” (Llamzon, 2014, pp.19, para. 2.01). A specific idea of corruption can vary greatly across countries, societies, and even individuals. “That is why it becomes difficult to define it. In sum, corruption is a cross-systematic, cross-temporal and cross-cultural phenomenon. It can exist in any place, at any time, and under any form of government” (Farrales, 2005, p.12). Corruption includes certain behaviors such as fraud, money laundering, drug smuggling, bribery, extortion and black market operations, among others. It harms democratic institutions, slows economic development and contributes to international political instability. According to Transparency International or T.I.<sup>1</sup>, corruption is the “abuse of entrusted power for private gain”. On the other hand, one of the principal anti-corruption treaties, the OECD Anti-Bribery Convention, does not contain a definition of corruption at all. Instead, it focuses on bribery of a foreign public official, which the treaty defines in the following terms:

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<sup>1</sup> It is a global movement that gives voice to the victims and witnesses of corruption. T.I. works together with governments, businesses and citizens to stop the abuse of power, bribery and secret deals.

To offer, promise, or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantages (Llamzon, 2014, pp.20).

Corruption can be classified as grand, petty and political, depending on the amounts of money lost and the sector where it occurs. According to T.I., the “abuse of high-level power that benefits the few at the expense of the many, and causes serious and widespread harm to individuals and society” is known as “grand corruption”. Secondly, “everyday abuse of entrusted power by public officials in their interactions with ordinary citizens, who often are trying to access basic goods or services in places like hospitals, schools, police departments and other agencies” is defined as “petty corruption”. Finally, “political corruption” according to T.I. is the “manipulation of policies, institutions and rules of procedure in the allocation of resources and financing by political decision makers, who abuse their position to sustain their power, status and wealth”.

According to Transparency International and the Corruption Perceptions Index of 2017<sup>2</sup>, the majority of countries are making little or no progress in ending corruption. The Index found that more than two-thirds of countries score below 50, with an average score of 43. The Cleanest countries are New Zealand, Denmark and Finland and the most corrupt are Syria, South Sudan

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<sup>2</sup> The index ranks 180 countries and territories by their perceived levels of public sector corruption according to experts and businesspeople, uses a scale of 0 to 100, where 0 is highly corrupt and 100 is very clean. [https://www.transparency.org/news/feature/corruption\\_perceptions\\_index\\_2017](https://www.transparency.org/news/feature/corruption_perceptions_index_2017).

and Somalia. Chile is in the 26<sup>th</sup> position with a score of 67 and Germany is in the 12<sup>th</sup> position with a score of 81 points.

On the other hand, international arbitration is an alternative to the domestic judicial system where parties from different countries may resolve their disputes without filing a lawsuit in court. It is a consensual process based upon the parties' mutual agreement to use arbitration as the dispute resolution method in which a non-governmental decision-maker examines the dispute and manufactures a legally final, binding and enforceable ruling (Bhojwani, 2012, p.76-77). Recently, arbitration has become a very common practice in global relations, with a variety of topics to deal with.

In recent times, there has emerged a relationship between corruption and international arbitration. Wrongdoings have appeared in commercial and investment arbitral cases. Corruption can arise at any time during the arbitration process; it may originate before, during and after the contract but also, during the arbitral structure and appointment of arbitrators. Arbitral tribunals have limited jurisdiction and limited power to compel parties to produce evidence, that is why, arbitration was not been the perfect mechanism to judge corruption. However, accusations about corruption in arbitral cases have increased dramatically. Corruption normally arises in two ways, in the context of international arbitrations. First, in investor-state arbitrations, where a state accuses an investor of obtaining a concession or other investment opportunity by way of corruption. Secondly, corruption can arise in the context of commercial arbitration, in a subtler way, payments to third parties by intermediaries, that appear not to be legitimate, and disputes arise as to the payment of sums due under such contractual agreements. Also, arbitral tribunals have had to deal with situations where parties do not allege corruption, but the facts determined



provide evidence or raise suspicions of wrongdoings. These are the situations that make arbitrators hesitate to recognize their jurisdiction.

Nowadays, there are many bilateral, multi or plurilateral investment treaties that underpin what we call international investment. International investment arbitration has emerged as the most effective means of resolving investor-state disputes. The International Centre for Settlement of Investment Disputes or ICSID is the world's leading institution devoted to international investment dispute settlement. It was established in 1966 by the ICSID Convention. Regarding disputes:

The type of dispute covered by the Convention is limited in several respects. It must be a legal dispute arising directly out of an investment. The dispute must be between a Contracting State – a country that has become a party to the Convention by signing and ratifying it – or a designated constituent subdivision or agency of the State on the one hand and a national of another Contracting State on the other hand (Parra, 2012, p.8).

Allegations about corruption in investor-state arbitration have been increasing, high levels of corruption, bribery and unstable economic policies can decrease the amount of foreign investment that a state might expect. That is why arbitration has been used to resolve the emerging disputes from it.

Within investment arbitration, corruption can arise in different situations. As I said above, the most common is when an investor submits an application for arbitration to repair monetary damages caused by a host-state's contraventions of the investment treaty. The host state may allege corruption whereby, it seeks to leave the investment out of the penumbra of the investment

treaty protection on the grounds of the infringement of the host-state's law (Uluc, 2016, p.7). By attacking the underlying contract with claims of corruption, states seek to dismiss any claims based upon the contract and thus dismiss jurisdiction of the tribunal.

It is important to establish here that one of the consequences of corruption can be the declaration of nullity of the main contract or the arbitration clause or agreement. In international arbitration there are three criteria to determine the validity of the contract: domestic law, international public policy and defective consent. Beginning with domestic law, it illustrates how corruption can vary from one country to another. A good example of this is the *World Duty Free Company Limited v. The Republic of Kenya* arbitral case (ICSID, 2006), where the tribunal applied domestic law and found the underlying contract unenforceable. Next, comes international public policy and order set of values, principles and rules that govern the international community. In this regard, an ICSID tribunal stated in the *Niko Resources v. Bangladesh, BAPEX, and Petrobangla* case (ICSID, 2013):

Normally, arbitral tribunals respect and give effect to contracts concluded by the parties which agreed on the arbitration clause from which they derive their powers. However, party autonomy is not without limits. In international transactions the most important of such limits is that of international public policy. A contract in conflict with international public policy cannot be given effect by arbitrators.

The last criteria is to investigate defects of the parties' consent, commonly used in litigation. In sum, contracts, treaties, clauses and rules that are contrary to international public policy will not be honored by arbitrators. Once the validity of the main contract is determined, the arbitration agreement or clause must be analyzed. From a logical perspective, if the main

contract is declared null, the arbitration clause should as well. However, there is a doctrine known as “separability” or “separability presumption” that helps resolve the issue.

The doctrine of separability permits the separation of an arbitration agreement from the contract if there are defects in the underlying contract. This principle is universally accepted and allows arbitral tribunal to retain jurisdiction notwithstanding a voided contract (Born, 2009, p.312).

A question that must be raised in terms of corruption allegations is the applicable law to determine the existence of wrongdoings, because the same behavior can be corrupt in one country but not in another. So, the law of the place or seat of arbitration, the law applicable to the merits of the matter and the law of the place of performance of the obligation, play a relevant role to these effects.

The virus of corruption exists, it is alive and will seek to survive and spread. International law must maintain the current antidotes to fight it and keep it away. Currently, there is a certain consensus that corruption is an arbitral subject. Examinations into corruption by a tribunal fall within its competence, if the existence of corruption is relevant to the resolution of the dispute submitted to it. Corruption in these cases opens the door to the demands of innocent foreign investors for violations of fair and equitable treatment. In most cases, international jurisprudence has not ruled in favor of invertors for lack of evidence of corruption. The arbitration system has become a tool for unscrupulous people to obtain undue benefits. Transparency will play a very important role in the purge of the arbitration institution. Cases with allegations of corruption have increased in recent years, in Latin America one of the most famous cases is the Odebrecht case in Brazil. In this case, a Brazilian construction company paid corrupt commissions in order to guarantee the obtaining of public contracts in 12 different countries, just to gain public

benefits. The Department of Justice of the United States is in charge of the investigation since some years ago. All these factors have played an important role in increasing the current level of enforcement about corruption in Brazil (Duprad and Pagotto, 2018, pp.91). Many of the disputes must be solved in the commercial arbitration room.

If we observe the work done by arbitrators in the last decade, as I will analyze in the next chapter, we can realize that with respect to allegations of corruption, arbitral tribunals have taken a more legalistic or formalistic attitude. The arbitrator tries to put aside his personal and philosophical opinions about corruption and replaces it with the means of proof. So, if one of the parties alleges corruption, the arbitrators first consider whether there is any other exception to their jurisdiction that is more evident and easy to analyze, if there is no other exception, the tribunal admits to study the merits of the corruption case, according to the arbitration procedure and the means of proof, finally, to dictate whether or not corruption has really existed. All arbitration decisions must not only be motivated but must be carried out in accordance with the applicable law and the arbitrator's own jurisdiction. Therefore, analyzing the standards of proof of the arbitral tribunals becomes more important.

## **2. General considerations regarding means of evidence, burden and standard of proof**

Arbitrators still labor with today's important and controversial issues, such as the standard of proof, the burden of proof, and evidence to be brought. Corruption has been part of human life for thousands of years, it is really difficult to prove because secrecy is inherent in these cases. That is why cases where corruption arises noteworthy questions such as: How to prove

corruption? Who carries the burden of proof? What is the level of the standard of proof? Who is responsible? This study and research aim to answer these questions.

The concepts of burden and standard of proof cause ambiguity and confusion in the context of international arbitration. A tribunal is not bound by complex rules of evidence or an appropriate standard of proof. There is no single theory or rule applicable regarding the burden of proof (Born, 2009). All of this, because one of the most important characteristics of arbitration that differentiates it from litigation is the flexibility of rules, where the parties can choose and decide all the proceeding. Consequently, “the use of rules of evidence would tend to constrain the very flexibility arbitration promises to provide” (Laird and others, 2018, p.4).

It is a national and an international principle that each party has to prove the facts upon which they rely to corroborate their claim or defense. It has been recognized by the International Court of Justice (ICJ), the World Trade Organization (WTO) dispute settlement panels, the International Centre for Settlement of Investment Disputes (ICSID), and the UNCITRAL Rules<sup>3</sup>, as well as in other international conventions and organizations. As a general rule, this principle operates similarly in international arbitration and it determines by the “burden of proof”.

The burden of proof is unquestionably borne by the party that wants to make a fact evident. Through this, the party wants to persuade the tribunal that its facts are evident and its *petitum* must prevail. Usually, the burden of proof lies on the plaintiff. However, it can often fall on the defendant, depending on the circumstances.

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<sup>3</sup> For example, Article 24 provides: “Every party shall have the burden of proving the facts relied on to support his claim or defense”.

The second important principle is to reach the required level of persuasion determined by decision-makers, known as the “standard of proof”. “Participants in investor-state arbitration typically submit that there is only one rule of evidence: the free appreciation of evidence by the arbitrator” (Schreuer and others, 2009).

It is important to highlight the difference between the burden and standard of proof, and according to the ICSID case No. ARB/06/3, *The Rompetrol Group N.V. v. Romania* (2013):

The Tribunal believes that the distinction between the two can be stated quite simply: the burden of proof defines which party has to prove what, in order for its case to prevail; the standard of proof defines how much evidence is needed to establish either an individual issue or the party’s case as whole. As soon as the distinction is stated in that way, it becomes evident that the burden of proof is absolute, whereas the standard of proof is relative.

There are different levels of the standard of proof including *prima facie*, preponderance of evidence, clear and convincing evidence, and beyond a reasonable doubt. As I will analyze in the next chapter, the standard of proof depends on whether we are taking about a civil or a criminal case. According to Scheweizer (2013):

Common law knows (at least) two different standards of proof, the “preponderance of evidence” (or “balance of probabilities in English Law) for civil cases and the “proof beyond reasonable doubt” in criminal cases.

In general, identifying the appropriate standard of proof in arbitral cases has been a challenge; most arbitral rules and international law do not provide detailed norms on the standard of proof. And regarding about issues of corruption, things are more complicated because there is

a no guidance conducting arbitral tribunal to the appropriate standard of proof. Much of the times, arbitral tribunals use their discretion to define a standard of proof. Sometimes, parties integrate into their contract a point relating to the standard of proof, so the arbitrator can follow it. The arbitral precedent in this respect exhibits that the majority of arbitral awards advocate a higher standard of proof due to the seriousness of the corruption allegations and its significant legal repercussions. However, establishing a standard of proof makes it easier for arbitrators to assess the evidence in each specific case and in this way, justify their decisions correctly.

The question that the standard of proof raises is what level of evidence is required to establish either a fact or an entire case? It is a rather complex question to answer that I will try to address in the next chapter.

## Chapter 2: Standard of Proof of Corruption in Investor-State International Arbitration

As I have indicated previously, most of the arbitration rules, national arbitration laws and international arbitration conventions do not contain specific rules on the burden and standard of proof, let alone in cases about corruption. Establishing corruption is, as a matter of fact, difficult. Corrupt payments will usually be hidden by seemingly legal transactions. In ICSID Case No. ARB/05/13 Award, EDF Services Limited v. Romania (2009, para.221), the tribunal expressed sympathy for the investor's position, that "[I]n any case, however, corruption must be proven and is notoriously difficult to prove since, typically, there is little or no physical evidence". This makes it difficult for arbitrators to assess the evidence. "Further, identifying the appropriate standard of proof poses enormous problems due to varying conception of the standards in civil and common law traditions" (Sourgens, Duggal and Laird, 2018, p.76).

However, there are some laws and rules applicable to the burden and standard of proof in international arbitration. For example, articles 49<sup>4</sup> and 50<sup>5</sup> of the Vienna Convention refer to corruption of a representative of a state and fraud and article 24 (1)<sup>6</sup> of the UNCITRAL Rules applies in international arbitration as a general principle known as *actori incumbit probatio*. In other words, in international arbitration, it is axiomatic that each party bears the burden of proving the facts relied on in support of its defense. However, no rule clearly establishes a standard of evidence applied to an arbitral case.

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<sup>4</sup> "If a State has been induced to conclude a treaty by the fraudulent conduct of another negotiating State, the State may invoke the fraud as invalidating its consent to be bound by the treaty".

<sup>5</sup> "If the expression of a State's consent to be bound by a treaty has been procured through the corruption of its representative directly or indirectly by another negotiating State, the State may invoke such corruption as invalidating its consent to be bound by the treaty".

<sup>6</sup> "Each party shall have the burden of proving the facts relied on to support his claim or defense".



Despite the absence of rules or laws regarding the standard of proof in international arbitration, arbitrators will attempt to base a decision on the burden and standard of proof and will attempt to establish the relevant facts with reasonable certainty irrespective of the burden and standard of proof. Even so, there are three standards of proof identified in investor-state arbitration. These are the pro tem or prima facie evidence, the balance of probabilities or preponderance of evidence and a higher standard of proof; arbitrators have had problems evaluating allegations of corruption since they are not judges, they do not have the same enforcement powers of a court to compel the production of evidence; then, evaluating the standard of proof has become a “headache” for arbitrators.

As the International Chamber of Commerce (ICC) tribunal constituted in Case No. 6497 (1994) remarked: “The party alleging corruption has the burden of proof. Such party may bring some relevant evidence for its allegations, without these elements being really conclusive”. This presupposes the idea of discretion of the arbitrators to evaluate evidence. Rose (2014, p.193) established that:

The procedural rules of ICSID, ICC and UNCITRAL leave the standard of proof to the discretion of the tribunal, and in practice tribunals have varied in their views on how stringently they should assess evidence of corruption. The instruments that regulate arbitral proceedings provide relatively little guidance on evidentiary matters, such as which party has the burden of proof, what sort of evidence the parties should present, and the standard of proof by which tribunals should evaluate the evidence before them ... While these instruments offer somewhat varying levels of guidance to tribunals on evidentiary matters, they uniformly omit any mention of the standard of proof. Thus,

under each set of procedural rules, tribunals have considerable freedom to adopt the standard of proof that they consider appropriate in the given circumstances.

Likewise, there is no clear consensus as to the standard of proof to be applied in investor-state arbitration, in respect of allegations of corruption. As I remarked before, civil and common law countries have differences in their perspectives of standards of proof. For civil law countries, the standard of proof is known as the “inner conviction of the judge”, or in the case of arbitration, the inner conviction of the arbitrator. In it, the only higher degree of probability required by the law is the criminal standard, known as “beyond reasonable doubt”. On the other hand, in common law countries, a higher standard of proof is necessary, in respect of alleging corruption, because of the seriousness of the allegations. From this perspective, a great difference is found. Some arbitrators come from a civil law education, and others from a common law one, this makes it even more difficult to establish a standard of proof.

The prevailing arbitral practice regarding the standard of proof required for allegations of corruption is a high standard of proof. Karsten and Berkeley (2003, p.115-117) established that:

In a survey of arbitral case law on corruption, it was found that in just one out of twenty-five cases, a “*low*” standard of proof was applied, whereas in fourteen cases, a “*high*” standard of proof applied, which were variously described as “*certainty*”, “*clear proof*”, “*clear and convincing evidence*”, and “*conclusive evidence*”.

In case No. ARB/05/15, Waguih Elie George Siag and Clorinda Vecchi v. Arab Republic of Egypt ICSID (2009, para. 326), the tribunal remarked: “It is common in most legal systems for serious allegations such as fraud to be held to a high standard of proof”. Also, in ICSID Case No. ARB/05/13, EDF Services Limited v. Romania (2009, para.221), the tribunal remarked that

“There is general consensus among international tribunal and commentators regarding the need for a high standard of proof of corruption”. That is to say, the applicable standard of proof is greater than the balance of probabilities but less than beyond reasonable doubt.

## **2.1 Corruption in Investor-State International Arbitration**

Investment arbitration has been a useful tool in the settlement of disputes between investors and the host state. Corruption may arise in numerous ways in investment arbitrations since they are based on international treaties. “It is generally alleged when respondents seek to dismiss plaintiff’s claims, which are generally contractual, such as damages or failure to perform” (Uluc, 2016, p.6).

According to Lamm and Menaker (2016, p.424):

“Allegations of bribery and corruption are increasingly common in investor-state disputes and have played a critical role therein. In particular, allegations of corruption have been raised by host States as a defense to either the tribunal’s jurisdiction or the admissibility of the claimant’s claims. Such allegations also have been raised by investors, who have argued that attempts by public officials to solicit bribes constitute violations of the fair and equitable treatment (“FET”) standard and other treaty provision”.

In other words, within investment arbitration, states allege corruption to dismiss the claim as a defense of the claimant’s claim; and, investors allege corruption to get a monetary reparation for the damages caused by the host state. Moreover, in these cases, the investor is required to make the investment in accordance with the legislation of the host state. If the investor does it through corrupt acts, it will not have the legitimacy to sue the state, and the arbitral tribunal loses

jurisdiction. Also, it may be the case that corruption have been made by the two parties, applying the previous statement, the host state can be released from liability, a huge problem.

About the consequences of corruption in investment arbitration Lamm and Menaker (2016, p.435) have explained: “[a]lthough many tribunals have remarked on the standard and burden of proof applicable to corruption allegations, very few tribunals have had occasion to analyze the consequences of a finding of corruption”. The first ICSID case in which corruption was addressed as a topic was the World Duty Free Co or WDF. v. Kenya ICSID case (2006). The investment issue at this case was a contract for the construction, maintenance, and operation of duty-free complexes at the international airports in Mombasa and Nairobi, in Kenya.

This case was based on the breach of a contract. Mr. Ali, president of the WDF, wanted to obtain the concession mentioned before. His Kenyan partner, Mr. Sajjad, recommended that he raise the request to obtain the concession directly to the President of Kenya. To do this, they went to the official residence of the President, carrying a briefcase with 2 million dollars, which they handed over to the president’s personal assistant. When they left, the assistant returned the case, but the dollars had been removed and it was full of corn. President Moi effectively ordered that the contract for duty-free stores be granted to WDF. Years later, problems arose in the execution of the contract and the Kenyan government canceled it on the grounds that the contract had been obtained through corrupt payments. Without taking into account that corruption came from both sides, on one hand, who gave the money and on the other who received it. So, WDF requested an arbitration.

The tribunal dismissed the WDF’s claim on the basis that corruption is contrary to international public order, and contrary to the applicable law of the contract, English and Kenyan Law. In this case, the evidence of the bribe and corruption was clear; however, the violation of

the international public order was enough to dismiss the case and leave the state of Kenya without liability, since the tribunal did not accept the actions of the president as attributable to the state of Kenya, a topic that I will analyze in the next chapter.

As I analyzed in the previous case, the consequences of corruption in investment arbitration are devastating, for both parties and the arbitral tribunal. For these reasons, establishing a correct standard of proof presupposes a greater responsibility for arbitrators.

## **2.2 Prima Facie Evidence as a Standard of Proof**

Identifying the appropriate standard of proof in arbitral cases has been a challenge for arbitrators. The first standard they have recognized is known as the *pro tem* or *prima facie* evidence. It occurs during the jurisdictional phase of the arbitral procedure. In words of Laird and others (2018, p.78), “the standard involves examination of the facts as alleges by the claimant to see whether such facts would amount to a breach of the treaty [underlying an investment treaty arbitration] and otherwise fall within the jurisdiction of the tribunal”.

According to this standard, a fact is presumed to be correct while no evidence is presented to proof the contrary. Laird and others (2018, p.78 - 79) state that:

“Under the *pro tem* standard, a claimant must submit evidence that, if unbranded, would meet the standard of proof to establish jurisdiction and further must plead, but not prove, sufficient facts to assert a claim for which relief may be granted. For matters that do not concern jurisdictional matters, the most common approach has been to follow the *pro tem* rule, ie a *prima facie* evidence, that has been applied by both the ICJ and investment tribunals”.

In *Metal-Tech v. Uzbekistan*, an ICSID case (2013), “the Republic of Uzbekistan submitted that certain facts are inherently difficult to prove. Therefore, the party alleging such facts may sustain its burden of proof through prima facie evidence, evidence which if unexplained or uncontradicted, is sufficient to maintain the proposition affirmed”.

It is important to determine here that there are some issues that must be proven in their entirety in the jurisdictional phase. Firstly, the jurisdiction of the arbitral tribunal must be clearly proven and can be proven through prima facie evidence, for example matters such as the nationality of the investor or the consent of the state, must be proven at this phase. Regarding the state’s consent, in ICSID Case No. ARB/07/30, *ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela* (Decision on jurisdiction and the merits, 2013, para.254) the tribunal established “in the words of the International Court of Justice in considering the very first challenge made to its jurisdiction, the consent must be voluntary and indisputable, and in words of both ICSID tribunals clear and unambiguous”. Secondly, in this phase also the arbitral tribunal determines if there are allegations about criminal situations<sup>7</sup>, if so, the tribunal decides that those allegations will need a higher standard of proof. So, the prima facie test will not be enough. However, some international tribunals have often accepted claims on the basis of prima facie evidence in instances where it remains unrebutted.

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<sup>7</sup> Such as allegations of corruption, blackmail, bribery, and other forms of wrongdoings.

### 2.3 Balance of Probabilities or Preponderance Evidence

This is the most common standard of proof used in arbitral proceedings. Laird and others (2018, p.80), stated that “this standard requires an evaluation of all evidence produced by both parties on a particular issue and this evaluation would ultimately result in the tribunal determining which party’s evidence was more likely than not to be true”. In other words, all the evidence is bundled and considered at one time clearly for the purposes of determining whether the burden of persuasion has been met. The application of a preponderance of the evidence standard, would provide a heightened degree of clarity by obliging a panel to consider all proffered evidence at the same time.

In the words of Nathan O’Malley (2012, p.208):

The standard predominantly applied is quite often the balance of probabilities test, as was confirmed by an ICSID tribunal composed of well-experienced arbitrators. The balance of probabilities standard generally calls for a claim to be upheld if the Tribunal is convinced by the evidence that the claim is more likely than not true.

Also, C. F. Amesasinghe has explained ‘preponderance of evidence’ as follows:

Preponderance of evidence’ means generally that there is evidence greater in weight in comparison with the evidence adduced by the other party on the basis of reasonable probability rather than possibility. What tribunals do is to weigh the evidence proffered by both parties (and the facts judicially noted by the tribunal itself), in order to determine whether the weightier evidence is in favour of the *actor* (the claimant or party bearing the burden of proof). The tribunal determines whether it is a reasonably probable that the *actor’s* claim is correct. Surprisingly, but perhaps understandably, where this

moderate standard has been applied the non-*actor* may often claim, if he loses, that too light a standard of proof was applied, while, on the other hand, where the *actor* loses, he will probably claim that a stricter standard of proof than the ‘preponderance of evidence’ has been applied.

This standard would extend to most situations in investor-state arbitration, except the limited categories where a heightened standard of proof would apply. Indeed, tribunals have also applied this standard to a wide range of issues, such as establishing disputed facts at the jurisdictional phase, claims for damages, allegations of breach of contract, interpretation issues, factual controversies, and for breaches of standard of protection (Laird and others 2018, p.81-82).

The balance of probabilities or preponderance of evidence standard is widely used in common law arbitration. However, some civil law arbitrators have observed that this standard is similar to the “inner conviction test” in which evidence is used to convince the judge or arbitrator. Whatever the judge considers appropriate in reaching the truth or moral certainty will be used in order to resolve any dispute.

In ICSID case No. ARB/08/1, *Marion Unglaube v. Republic of Costa Rica* (Award, 2012), the tribunal held:

Whichever party bears the burden of proof on a particular issue and presents supporting evidence “must also convince the Tribunal of its truth, lest it be disregarded for want, or insufficiency, of proof.” The degree to which evidence must be proven can generally be summarized as a “balance of probability,” “reasonable degree of probability” or a preponderance of the evidence. Because no single precise standard has been articulated, tribunal ultimately exercises discretion in this area.



The application of the standard has been the subject of considerable debate, sometimes even between different members of the arbitral tribunal. The problem of this standard is that some of arbitrators have different points of view relating to evidence; persuading arbitrators becomes increasingly difficult considering this. Moreover, the tribunal has the broadest powers to assess the evidence as it deems reasonable, but when talking about acts of corruption it is indisputable that the tribunal must adopt a higher standard of proof than this one.

## **2.4 A Higher Standard of Proof**

As I have indicated previously, arbitral tribunals have adopted a higher standard of proof for allegations of corruption. Establishing corruption is, as a matter of fact, difficult. The evidence is usually not readily available. This standard is higher than the balance of probabilities or preponderance of evidence but lower than the standard of proof named beyond reasonable doubt, used in criminal law. In ICSID Case No. ARB/05/15, *Waguih Elie George Siag and Clorinda Vecchi v. Arab Republic of Egypt* (Award, 2009 para.326) the tribunal pointed out that “it is common in most legal systems for serious allegations such as fraud to be held to a high standard of proof”.

Nathan O’Malley has explained the heightened standard of proof as follows:

For those allegations of particular gravity, a tribunal may find it necessary to apply a higher standard of proof. One finds examples of this in sports arbitrations convened to consider questions over the use of performance-enhancing drugs, where tribunals often will, as a matter of practice, require more than the general balance of probabilities standard of proof applicable to most commercial and contract claims, but less than the standard of *beyond reasonable doubt* applied in criminal proceedings. Other claims, such

as those brought on the basis of fraud or forgery, will attract a higher standard of proof which is articulated as requiring evidence that is *clear and convincing* or higher. The gravity of a claim is determined according to the nature of the allegation, not according to personage of the party against whom it is levelled. (Sourgens, Duggal and Laird, 2018, p.85-86).

Although there is no specific regulation relating to the law applicable to the standard of proof, as noted above, for cases involving corruption, bribery or fraud, a higher standard of proof should apply by virtue of the seriousness of the allegations.

## **2.5 The Special Case on Corruption: Circumstantial Evidence**

In practice, it is very rare that direct proof of corruption is available. Most arbitral tribunals have to content themselves with circumstantial evidence (Scherer, 2002, p.31). Moreover, as there will be a lack of direct evidence regarding allegations of corruption, mere insinuations of wrongdoings would not meet the high evidentiary standard and will not persuade arbitrators. However, circumstantial evidence plays an important role in arbitral cases when direct evidence will be almost impossible to have. Circumstantial evidence determines a different standard of proof on corruption issues. Investor-state tribunals have noted that circumstantial evidence could be admissible, particularly in situations where direct evidence might be difficult, but further corroboration would be necessary and a heightened standard above the balance of probabilities would apply.

It is recognized that circumstantial evidence may be sufficient to establish corruption. Some arbitral tribunals add to this that circumstantial evidence must be clear or indices of corruption must be serious. Circumstantial evidence, because of its nature, requires a multitude of indices

which allow one to conclude that corruption is established. Some indices for corruption may, or course, be given more or less weight than others in the circumstances of each case, and no rigid rules may be stated in this respect.

Llamzon (2014) has written that “circumstantial evidence, particularly when direct evidence of corruption is unavailable, is widely, albeit cautiously, accepted as a tool to evaluate allegations of corruption by international tribunals”. Also in ICSID Case No. ARB/11/12 Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines (Award, 2014, para.479), the tribunal established that:

The tribunal holds that considering the difficulty to prove corruption by direct evidence, the same may be circumstantial. However, in view of the consequences of corruption on the investor’s ability to claim the BIT protection, evidence must be clear and convincing so as to reasonably make believe that the facts, as alleged, have occurred.

Also, in ICSID Case No. ARB/10/03, Metal-Tech LTD. v. The Republic of Uzbekistan (Award, 2013, para.243) stated:

The tribunal will determine on the basis of the evidence before it whether corruption has been established with reasonable certainty. In this context, it notes that corruption is by essence difficult to establish and that it is thus generally admitted that it can be shown through circumstantial evidence.

According to ICSID Case No. ARB/05/16, Rumeli Telekom AS and Telsim Mobil Telekomunikasyon Hizmetleri AS v Republic of Kazakhstan (Award, 29 July 2008), article 34 (1) of the ICSID Arbitration Rules provides that the arbitral “Tribunal shall be the judge of the

admissibility of any evidence adduced and of its probative value”. Therefore, the tribunal is not bound by any legal system of procedure. It is free to determine the probative value of any evidence that has been produced, be it circumstantial or otherwise.

Some authors have expressed that there are special rules regarding circumstantial evidence known as connecting the dots and red flags. The first one is explained in *Methanex Corp v. United States*, UNCITRAL Award (August, 2005), observing that “while individual pieces of evidence when viewed in isolation may appear to have no significance, when seen together, they provide the most compelling of possible explanations of events”. Also, “connecting the dots is hardly a unique methodology; but when it is applied, it is critical, first, that all the relevant dots be assembled; and, second, that each be examined, in its own context, for its own significance, before a possible pattern in essayed”. In other words, the first special rule of circumstantial evidence it is a way to connect certain points that are evident through the process and together would show a corrupt act.

The second special rule is known as red flags. According to Laird and others (2018, p.97) “red flags are series of actions, typically representative of fraudulent activity, such as locations in tax havens, multiple beneficial owners, multiple transactions through bearer shares, cash transaction etc.” In ICSID Case No. ARB/10/03, *Metal-Tech LTD. v. The Republic of Uzbekistan* (Award, 2013, para.293) the tribunal explained that:

For the application of the prohibition of corruption, the international community has established lists of indicators, sometimes called “red flags”. Several red flag lists exist, which, although worded differently, have essentially the same content. For instance, Lord Woolf, former Chief Justice of England and Wales, included on his list of ‘Key Red Flags’ among other things’ (1) ‘an Adviser has a lack of experience in the sector;’ (2)

‘non-residence of an Adviser in the country where the customer or the project is located;’ (3) ‘no significant business presence of the Adviser within the country; (4) ‘an Adviser requests ‘urgent’ payments or unusually high commissions;’ (5) ‘an Adviser requests payments be paid in cash, use of a corporate vehicle such as equity, or be paid in a third country, to a numbered bank account, or to some other person or entity;’ (6) ‘an Adviser has a close personal/professional relationship to the government or customers that could improperly influence the customer’s decision’.

In this leading case, Metal Tech was an Israeli investor in Uzbekistan, which alleged that its investment had been expropriated and claimed compensation under the treaty between Israel and Uzbekistan. The state objected that the investments had been promoted through corrupt payments to officials, and that the tribunal therefore had no jurisdiction over the dispute. In the course of the arbitration, Metal-Tech acknowledged having paid 4 million dollars to three Uzbek advisors.

As to the standard of proof, the tribunal limited itself to stating that it is difficult to prove the existence of corruption, due to its own nature, and that it is almost always done through circumstantial evidence. After a joint assessment of the entire evidence, the arbitral tribunal concluded that the payments made to the 3 advisors masked corrupt payments, which constituted a crime in Uzbekistan. So, it determined that the investor had not fulfilled his duty to invest in accordance with the laws of Uzbekistan, and that the tribunal lacked jurisdiction and the tribunal dismissed the case.

In conclusion, a red flag is a fact, event, or set of circumstances, or other information that may indicate a potential legal compliance concern for illegal or unethical business conduct,

particularly with regard to corrupt practices and non-compliance with anti-corruption laws. A red flag list is a tool for inquiry and manage corruption risks around the international world.

Lastly, corruption is considered a misconduct with serious consequences. From my point of view, corruption should be established using solid and consistent evidence. By means of evidence that will satisfy the burden and standard of proof in each case. Although, arbitral tribunals have authority to freely choose which evidence is admissible or which is excluded, when allegations of corruption arose, the tribunal should apply a higher standard of proof due to the seriousness of the corruption allegations and the legal repercussions that could exists and in this way achieve, as I will analyze in the next chapter, that any indicator of corruption contains an ingredient of responsibility.

### Chapter 3: Evaluating the State Liability

From the international perspective, international responsibility is understood as the obligation of a state to repair and satisfy another state for the consequences of a wrongful act (Arellano, 1993, p.211). Peaceful coexistence among states that composes the international community, is based on compliance with international legal obligations, as well as the establishment of a liability scheme that allows compensation for damages arising from a possible breach.

After more than fifty years of work, the International Law Commission codified the general (customary) regime for state responsibility in the Articles on Responsibility of States for Internationally Wrongful Acts, which were adopted in 2001. The law of state responsibility is based on the distinction between two types of rules: primary rules, which are those that establish the obligations of states, and secondary rules, which are concerned with the breach of primary rules and with the consequences of such breach; the term state responsibility is now widely used to denote secondary rules (Fitzmaurice, 2008, p.1).

The ILC codification is divided in three important parts: the first one is the responsibility of states for internationally wrongful acts of 2001<sup>8</sup>, the second one is the prevention of transboundary harm from hazardous activities of 2001<sup>9</sup>, and the draft principles on the allocation of loss in the case of transboundary harm arising out of hazardous activities of 2006<sup>10</sup>.

The ILC Responsibility Articles on state responsibility apply to all types of international obligations regardless of their source, subject matter, or importance to the international

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<sup>8</sup> Text adopted by the Commission at its fifty-third session, in 2001, and submitted to the General Assembly as a part of the Commission's report covering the work of that session.

<sup>9</sup> Text adopted by the Commission at its fifty-third session, in 2001, and submitted to the General Assembly as a part of the Commission's report covering the work of that session.

<sup>10</sup> Text adopted by the International Law Commission at its fifty-eighth session, in 2006, and submitted to the General Assembly as a part of the Commission's report covering the work of that session (A/61/10).

community. They apply to both acts and omissions, to treaty obligations and customary norms, to breaches of bilateral as well as multilateral obligations, and the whole gamut of particular subject areas, human rights law, environmental law, humanitarian law, economic law, the law of the sea and so forth (Bodansky and Crook, 2002, p.779-780).

Another important point to analyze here is the foundation of responsibility. In relation to this issue, the doctrine and international jurisprudence are divided, because for some, the international responsibility of the state derives simply from the breach of an international legal obligation (objective theory), while for others, there must also be fraudulent or culpable behavior on the part of the infringing state (subjective theory). It should be noted that the position that the ILC project has finally followed has been to adopt both theories, that is, the objective theory of state responsibility, dealing with unlawful acts perpetrated by agents or organs of the state, and a subjective theory for unlawful acts committed by individuals (Novak and Garcia, 2016, p.389-460). For example, article 7 of the ILC Articles on state responsibility provide that an act of a person empowered to exercise elements of governmental authority shall be considered an act of the state even if such person exceeds its authority or contravenes instructions.

According to article 1 of chapter 1 of the Articles on the Responsibility of states for international wrongful acts, “Every internationally wrongful act of a state entails the international responsibility of that state”. Also, article 2 explains that “There is an internationally wrongful act of a state when conduct consisting of an action or omission: (a) is attributable to the state under international law; and (b) constitutes a breach of an international obligation of the state”, established many times in a bilateral or multilateral investment treaty.

Article 12 of the text states that “There is a breach of an international obligation by a state when an act of that state is not in conformity with what is required of it by that obligation,



regardless of its origin or character”. In this context, the ILC refers to “obligation” because it presupposes a breach of any of the sources of international law, such as custom, a treaty, a general principle of international law, a unilateral act of the state or acts of international organizations, and may also be derived from a judicial judgment or an arbitral award.

To analyze the liability of a state in cases where allegations of corruption appear, it is essential to establish what behavior attributable to a person, contrary to international law, generates responsibility. To determine this, it is necessary to define who has representation of the state by mandate of internal law. The quality of an agent is determined by the internal law of each state (Novak and Garcia, 2016, p.389-460). Article 4 of the ILC stated the first rule:

1. The conduct of any state organ shall be considered an act of that state under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the state, and whatever its character as an organ of the central government or of a territorial unit of the state.
2. An organ includes any person or entity which has that status in accordance with the internal law of the state.

As a result, it is a universal principle that a state is responsible for the actions of agents who act in the exercise of their functions. However, article 7 of the ILC, as I explained above, also provides for the international responsibility of the state when an agent exceeds his functions or contravenes instructions. On the other hand, if a person acts in an individual capacity and committed wrongful act, there would be no responsibility for the state. All of the above is established in the ILC with precision.

### **3.1. Asymmetry in investor-state cases involving corruption allegations**

As I explained above, in international law, states are held to account for internationally wrongful acts through the law on state responsibility. A state is a juridical entity, after all, and its incorporeal being can only operate through the corporeal acts of the individuals and groups that represent it; these are by necessity deemed the acts of the state itself (Laird and others, 2018, p.99). However, some authors like Llamzon (2014) have established that when it comes to allegations of wrongdoing in investor-state arbitration, an investor is held solely responsible for creating an asymmetry.

This asymmetry relates, in the context of investment-related disputes, to the usual scenario where the investor lodges a claim against a host state through investor-state arbitration. However, recent years have seen a steady rise in investment treaty cases where host states have defeated a claim by the investor by invoking the defense of corruption. Thus, when a tribunal rejects an investment treaty claim at the jurisdictional stage on a finding of corruption involving both the investor and the state, an asymmetry is created wherein the investor with potentially legitimate investment claims is penalized and the state is exonerated from any liability arising from breach of its treaty obligations and even, unjustly enriched.

In words of Laird and others (2018, p.99):

States are routinely made responsible for the breaches of international obligations committed by their representatives, and a State is not excused from responsibility for acts perpetrated by its public officials simply because those acts were illegal, unsanctioned, or otherwise outside their scope of authority. When a Head of State or cabinet minister orders measures that are tantamount to the unlawful

expropriation of an investment, for example, or a State's domestic courts render judgments that disrupt the financial viability of an investor's investment, the State itself is routinely held liable by arbitral tribunals, and it is no argument that the public official acted in excess of his powers or contrary to national law, or that courts are independent and cannot be controlled by the government and thus could not have been acting on behalf of that State.

In conclusion, in most cases where public officials of a state participated in corruption, almost never seems to engage the responsibility of the state; although, international rules and regulations establish otherwise.

A good example of this asymmetry is provided by the *World Duty Free v. Kenya* case. In the award rendered in that case, the arbitral tribunal dismissed the claim in the understanding that corruption is contrary to international public order, Kenyan law and English law. In this case, the bribe was made by the investor of the president of Kenya; however, according to the arbitral tribunal the president's actions did not represent an action of the Kenyan state because "the payment to President Moi was 'covert', its receipt is not legally to be imputed to Kenya itself" (Laird and others, 2018, p.100). Also, the investor was party to the bribe, and for that reason the tribunal found that the claimant's claim had no foundation. In that way, Kenya was released from liability.

In this type of contract obtained through corrupt payments, as we can see in this case, the disputes arise when the corrupting company demands the fulfillment of the contract, and the state opposes, alleging as a defense that the contract was obtained through corrupt payments in this case the arbitral tribunal must take into account the conduct of each party, to determine the corresponding degree of responsibility.

Another case that shows this asymmetry is the *Metal-Tech v. Uzbekistan* case, analyzed above. In this case, the tribunal also dismissed the case because of lack of jurisdiction. Very large sums of money had been paid to consultants and the question was whether sums of money had been paid as a bribe or had been paid for lawful services (ARB/10/03, 2013, para.244-266). Moreover, in this case, the responsibility of proving corruption fell on the plaintiff; however, the tribunal concluded that the claimant was unable to substantiate its contention that actual services had been carried out for legitimate purposes. Also, according to the tribunal, the investment was not implemented in accordance with the BIT, enough reasons to dismissed the claim.

However, in this case also the responsibility fell on the investor, but what happens with the payments received by the agents of the government of Uzbekistan? The tribunal breaks again with the general principles of state responsibility dismissing the case.

In addition, the *Spentex v. Uzbekistan* ICSID Case No. ARB/13/26, also shows this asymmetry. The claimant in this case was Spentex Netherlands, B.V. (SNBV), a company incorporated in the Netherlands, and the respondent was the Republic of Uzbekistan. Spentex initiated an ICSID arbitration in September 2013 on the basis of the Netherlands-Uzbekistan BIT, Uzbek investment law, an Investment Agreement between the Uzbek government and Spentex Industries Limited (SIL) and the ICSID Convention (Betz, 2017, p.128). In this award still unpublished, the tribunal found that the investor was engaged in corrupt practices in the making of its investment, so dismissed its claim. On the other hand, also the tribunal found the respondent state was engaged in corrupt practices and for the first time reprimanded the respondent state by urging it to make a substantial payment to an international anti-corruption institution, under threat of an adverse costs order. The arbitrators penalized both the investor and the respondent state.

It is not common that in the context of investment arbitration, the consequences of a positive finding of corruption for the respondent state to be investigated and sanctioned. After having analyzed the responsibility of the state in these cases, there is no doubt that it bears liability for the respondent state in the case of inducing the claimant investor to commit an act of corruption. It seems clear in this case the imbalance between the investor and the state that has not been analyzed yet. It is clearly necessary a more immediate reaction to host states' corrupt behavior (Asoskov, Muranov, Khodykin, 2018, p.178).

### **3.2 State liability in the Chevron v. Ecuador case**

Considered one of the largest cases of environmental pollution, this case began in 1991 with the complaints of indigenous communities and farmers affected by oil spills of the company Texaco, acquired in 2001 Chevron, in the Amazon of Ecuador between 1964 and 1990. The case began with a sentence issued by a court in Lago Agrio, Ecuador in 2011 that ordered to pay a compensation of 9.500 million dollars to those affected. After two years, the Ecuadorian National Court of Justice, ratified the first sentence but issued another sum of money of 8.600 million dollars in reparations for the environmental damages in one of the areas of greatest biodiversity in the world. However, Chevron appealed the rulings and litigated the court decisions before national courts in Ecuador and the Permanent Court of Arbitration in The Hague. I will try to explain basically the four stages before the arbitral award of the Permanent Court of Arbitration (PCA) tribunal:

- ❖ Lago Agrio Judgment of 14 February 2011: According to the award “the Lago Agrio Judgment appears to be a lengthy, detailed, reasoned and powerful decision” (Award, 2018, para. 5.4). The Lago Agrio Judgment contains a lengthy passage addressing the issue of the “merger” between Texaco and Chevron, resulting in Chevron standing in the

shoes of both Texaco and TexPet (Award, 2018, para 5.18). In this judgement one of the principles and rules that prevails is the principle of good faith. However, one of the major problems is that the claimants content that the Lago Agrio Judgement incorporated eight sets of material which were never actually filed by the Lago Agrio plaintiffs during the Lago Agrio Litigation, and were thus never seen by the claimants during that litigation.

As the PCA tribunal established at part V of the award on page I, this judgment “awards US\$ 18.2 billion in damages to be paid by Chevron, including US\$ 8.6 billion as punitive damages subject to a timely public apology by Chevron, with a 10% award to the ADF”. Also, the beneficiary of compensation “shall be the Amazon Defense Front or the person or persons it designates, considering that those affected by the environmental harm are undetermined”, stated the “trust” (C-931, p.186-187).

An important issue that was discussed in this process was that if the Judge Zambrano, who was in charge of the case, was the one who wrote or did not write the Lago Agrio Judgment. After the evidence was analyzed, the tribunal determined that Judge Zambrano did not prepare the Judgment, since the time and the amount of material and evidence given in the case was huge, and a Judgment would not be written in less than three months as he specified in his declaration. In part 5.17 of the award, the tribunal stated that “it was ‘ghostwritten’ by certain of the Lago Agrio Plaintiff’s representatives with Judge Zambrano’s corrupt connivance”. Also, the Lago Agrio Judgment incorporated eight sets of material which were never filed by the Lago Agrio Plaintiffs during the Lago Agrio Litigation, and were thus never seen by the Claimants during that Litigation. It is noticed from here that corruption played an important role in Ecuadorian internal judicial process.

- ❖ Judgment of the Lago Agrio Appellate Court of 3 January 2012: “By its judgment of 3 January 2012, extending over 16 pages, the Lago Agrio Appellate Court affirmed the Lago Agrio Judgment. It upheld the punitive damages award because Chevron had refused publicly to “apologize”. It also decided that it could not address Chevron’s fraud allegations regarding the conduct of the Lago Agrio Litigation” (PCA, 2018, Part V – Page 49). Also, the Appellate Court confirmed that claims were diffuse and not as individual claims by a plaintiff seeking compensation for personal harm to that individual plaintiff.

As to Chevron’s “fraud allegations, the appellate courts established that:

Mention is also made of fraud and corruption of plaintiffs, counsel and representatives, a matter to which this Division should not refer at all, except to let it be emphasized that the same accusations are pending resolution before authorities of the United States of America due to a complaint that has been filed by the very defendant here, Chevron, under what is known as the RICO act, and this Division has no competence to rule on the conduct of counsel, experts or other officials or administrators and auxiliaries of justice, if that were the case.

At paragraphs 5.171 the tribunal established that “the appellate court specifically refused to fulfil its obligation to perform a comprehensive review of both the facts and the law regarding the dispute, as well as the allegations of fraud, as Chevron Corporation had requested it to do”.

❖ Judgment of Cassation Court of 12 November 2013: The Cassation Court reduced the Lago Agrio Judgment's award of damages to US\$8.6 billion, with 10% to be paid to the ADF. Also, the tribunal established that the Court "did not review the merits of any of Chevron's allegations of fraud in the conduct of the Lago Agrio Litigation or the 'ghostwriting' of the Lago Agrio Judgment. However, in commenting upon the Cassation Court's lack of jurisdiction to adjudicate upon Chevron's allegations, the Cassation Court noted that these allegations were being heard in the pending RICO litigation in New York, USA" (PCA, 2018, Part V – Pages 57-58).

The grounds for Chevron's cassation appeal included: (i) the inadequate application, lack of application or erroneous interpretation of procedural rules resulting in the irremediable nullity of the proceedings or in the appellant's defenselessness, provided they have influenced the judgment and that the respective nullity has not been legally validated; (ii) the judgment's lack of formal requirements provided for by law or the adoption of incompatible or contradictory decisions in the judgment's operative part; (iii) an extra petita or infra petita judgment; (iv) the inadequate application, lack of application or erroneous interpretation of applicable evidentiary rules, provided they lead to an erroneous application or to the lack of application of legal rules in the judgment; and (v) the inadequate application, lack of application or erroneous interpretation of applicable legal rules, including mandatory judicial precedent, which were determinative for the judgment's operative part. In short, these grounds included Chevron's fraud allegations and the 'ghostwriting' of the Lago Agrio Judgment (PCA, 2018, Part V, p. 53-54).



Reading the Award of the PCA, the tribunal concluded that the Cassation Court did not review any expert reports, did not review whether there had been any procedural fraud committed by the Lago Agrio Plaintiffs' representatives and did not consider anything about the "ghostwritten".

- ❖ Judgment of the Constitutional Court of 27 June 2018: The Constitutional Court issues its judgement on 27 June 2018, affirming the judgment of the Cassation National Court, following public hearing held on 16 July 2015 and 22 May 2018. The Constitutional Court declared that there is no violation of constitutional law, as alleged by Chevron; the Court rejected the Extraordinary Action of Protection made by Chevron; and it ordered its judgment to be recorded, published and enforced (PCA, 2018, Part V – Page 58).

Under Chapter 1 of the Judgment, the Constitutional Court decides that there was no infringement of Chevron's "right to be tried by a competent judge and in pursuance of the corresponding due process of law applicable to each proceeding"; the Lago Agrio Court, the Lago Agrio Appellate Court and the Cassation Court.

The Constitutional Court decides that the Cassation Court had no power to decide Chevron's allegations of procedural fraud. It states, as follows:

It should be remarked that the cassation appeal does not constitute another trial stage in the court proceedings, wherein issues of fact previously reviewed by the trial court judges can be freely discussed; but rather, it is by means of the cassation appeal that the judges of the National Court of Justice, who are in charge of hearing such an appeal, undertake a review of the jurisdictional activity of the lower trial court judges, in respect of the

application of the rules of law within their judgments or orders intended to close declaratory proceedings or trials. It is thereby ruled out any possibility that the cassation court judges may order the production and examination of evidence, make any assessment of the evidentiary elements or being to discuss any facts previously heard by the trial court judges, since any such actions would result in an infringement of judicial independence and legal certainty, duly guaranteed by the Constitution of the Republic of Ecuador.

The Constitutional Court decided that the Cassation Court had no power to decide Chevron's allegations of procedural fraud and that the Cassation Court's Judgement did not breach any constitutional right.

After the different phases of this long process, Chevron appealed the judgments at the Permanent Court of Arbitration or PCA. The PCA tribunal held in an award of 2018 that Ecuador must pay to Chevron compensation for damages to be fixed subsequently. In part VIII of the award, the tribunal addressed the merits of the Claimant's claims and the Respondent's defenses under the Fair and Equitable Treatment standard and customary international law in Article II(3)(a) of the Treaty and under the umbrella clause in Article II(3)(c) of the Treaty.

Regarding the obligations observance clauses, namely, umbrella clauses, are aimed to elevate contractual and other commitments of host states under an investment treaty's protective umbrella, the arbitral tribunal found that Chevron was released of responsibility under the 1995 settlement agreement. As a result, the tribunal had held, although the settlement agreement did not protect the claimants from claims of individual harm, it did protect both claimants from any collective or diffuse liability for environmental harm. For the tribunal, this contractual obligation

fell within the protective rubric of the BIT's umbrella clause, meaning that any failure by the Ecuadorian legal system to comply with the settlement would consequently breach the BIT (Hepburn, 2018).

In paragraphs 8.9 of the award, the tribunal established that “in the tribunal's view, by acts of its judicial branch, attributable to the Respondent under article 4 of the ILC articles on state responsibility, the Respondent violated its obligations under article II (3)(c) of the treaty, committing international wrongs towards each of Chevron and TexPet”. In conclusion, the tribunal decided that Ecuador was liable to make reparation to Chevron.

Referring to the “ghostwriting” of the Lago Agrio Judgment, the arbitral tribunal decided that “the Judge Zambrano did not write the Lago Agrio Judgment”, and that the Judge Zambrano did receive a bribe of US\$500.000. According to articles 4 and 7 of the ILC articles, the misconduct of Judge Zambrano and also other judges of the Lago Agrio Court was attributable to Ecuador. On part 8 paragraph 52, the tribunal concluded that “there can be no question as regards the attribution to the respondent of an international wrong committed by the Lago Agrio Court (with the Lago Agrio Appellate, Cassation and Constitutional Courts), as the judicial branch of the respondent acting in such capacity in the Lago Agrio Litigation”.

The arbitral tribunal also decided referring to the denial of justice that “the tribunal adopted the claimants' description that this ‘must be the most thorough documentary, video, and testimonial proof of fraud ever put before an arbitral tribunal’. Thus, a denial of justice was held to have occurred on March 1, 2012, when the Lago Agrio judgment became enforceable. The judgment was ‘clearly improper and discreditable’, and the appeal process had failed to correct it, leading to a failure to observe the minimum standards of international law” (Hepburn, 2018).

In the tribunal's final conclusions, "the Tribunal decides that the Respondent is liable to make reparations to each of Chevron and TexPet for injuries caused by the breaches of the FET standard and customary international law in Article II(3)(a) of the Treaty and for breaches of the Umbrella Clause in Article II(3)(c) of the Treaty, as further addressed in Parts IX and X below" (PCA, 2018 Part VIII-Page 21).

Finally, as we can establish from the information and issues above, this is one of the more serious cases of judicial corruption, the Lago Agrio Judgment breached principles such as the rule of law, access to justice and public confidence in the legal system. This Judgment violated international public order and determined the liability of a state in an arbitral award when corruption is alleged. According to the above, all states should not recognize or enforce the Lago Agrio Judgment.

### **3.3 Approach to the relationship between corruption and the environment**

"The energy giant Chevron beats Ecuador in an International Tribunal for the case of pollution of Lago Agrio". This was the headline of a new in the portal of BBC News of 7 September 2018<sup>11</sup>. The Chevron case, as I analyze it from the perspective of the responsibility of the State of Ecuador, it is not simply a case of litigation over environmental issues and pollution. It reveals the power of corruption in countries where the leadership has no respect for the rule of law and how corruption can affect the environment.

Corruption is an issue that has gained prominence in Latin America, as I explained above. Recently, it has emerged a relationship between corruption and the environment, it has been shown that corruption has serious consequences for the environment. Also, corruption exists at

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<sup>11</sup> Consulted in: <https://www.bbc.com/mundo/noticias-america-latina-45454965>.

all levels, from embezzlement during the execution of environmental programs or contracts to large-scale corruption when issuing permits and licenses for the exploitation of natural resources, including bribes to officials. When corruption causes the loss of resources and habitats and the destruction of ecosystems on which billions of people around the world depend, both societies and the environment suffer consequences (UNODC, 2015).

One of the major problems discussed in the Chevron case was water pollution. Ecuador accused the US company of causing environmental damage, mainly to water sources of the population of Ecuador, especially indigenous communities, through the work carried out by Texaco in the region of Lago Agrio. The pollution included crude oil as the arbitral tribunal stated in paragraph 4.71 of the award “There is today crude oil pollution in the former concession area of the Oriente, including pollution lying close to human habitation”.

Corruption in the water sector is a serious concern in many ways. As a source of energy, drinking or for sanitation purposes, water is a basic human need. Unfortunately, everyday millions of people have difficulty meeting that need. The water sector is especially vulnerable by corruption for various reasons. The main one is the large number of instances that intervene in the sector, including public and private entities. When a lot of money moves and transparency is lacking, the negotiation of contracts, assignments, agreements and licenses suffers.

However, in the arbitration administered by the Permanent Court of Arbitration or PCA, the tribunal issued a decision on the dispute. The decision, which is binding, rejected a 2011 decision of the Ecuadorian judicial system that ordered Chevron to pay UDS 9.5000 million compensation for environmental and other damages that took place in the Amazonian region of Ecuador, supposedly due to oil pollution. The PCA held that the judgment of the Ecuadorian court was illegal because it was obtained based on fraud, bribery and corruption. The court

criticized the Ecuadorian court and the judge of the case, alleging that they violated international public order.

Regarding to this, the PCA tribunal (Award, 9.16, 2018) held that:

In *World Duty Free* (2006), in the context of corruption by bribery, the tribunal identified, as a matter of international public policy, an international consensus as to universal standard and accepted norms of conduct that must be applied in all for a. It concluded: “In light of domestic laws and international conventions relating to corruption, and in light of the decisions taken in this matter by courts and arbitral tribunals, this Tribunal is convinced that bribery is contrary to the international public policy of most, if not all, States ...”. In the Tribunal’s view, judicial bribery must rank as one of the more serious cases of corruption, striking as the rule of law, access to justice and public confidence in the legal system; and also, as regards the foreign enforcement of a corrupt judgment, at the law of nations. Accordingly, the Tribunal concludes that the *Lago Agrio* Judgement (with the judgements of the *Lago Agrio* Appellate, Cassation and Constitutional Courts) violates international public policy. As a matter of international comity, it must follow that the *Lago Agrio* Judgment should not be recognized or enforced by the courts of other states.

The huge problem was that in 2007 Rafael Correa was elected President of Ecuador. Correa, a leftist, became interested in the case when he tried to influence the decision of the court causing the detriment of Chevron through a multimillion-dollar publicity campaign using public funds, a fact that was recently denounced by the current Ecuadorian government. The decision of the Ecuadorian court against Chevron that ordered it to pay UDS 9.500 million was ratified by the

Constitutional Court of Ecuador. However, the members of the court that made that decision were tied to Correa, and obviously responded to his wishes, in the opinion of some Ecuadorians (Fleischman, 2018).

The government of Lenin Moreno, the current President of Ecuador, said in a statement that he requested audits to identify those responsible for the failed trial against Chevron. He promised that he will establish “civil, criminal and administrative responsibilities that may be brought against those responsible for the most serious damage caused to the Ecuadorian State”. The secretary of the Ecuadorian presidency, Eduardo Jurado, explained that the award exposed the state to the payment of amounts still undetermined, but that can already be expected large sums of money, which could cause serious damage for the treasury (BBC News, 2018).

But this problem goes much further than it seems. So far, I have only analyzed the relationship between corruption and the environment; but, it seems to be a relationship between human rights and corruption. It is clear, that the arbitral tribunal left aside and did not venture to decide in depth all items related to the victims. The arbitral tribunal did not clearly establish who is responsible for the environmental damage, it left without effect an Ecuadorian internal judgment that had given reason and hope for an entire community in Ecuador to determine responsibility for that water pollution. In this regard, the tribunal (Award, 7.39, 2018) held:

In the Tribunal’s view, therefore, it remains clear that individual claims for personal harm from environmental damage, made by the Aguinda Plaintiffs in the Aguinda Litigation in New York or similar claims for personal harm (not being diffuse claims) made by the Lago Agrio Plaintiffs in the Lago Agrio Litigation, are not and cannot be claims asserted by the Respondent in its own right against Chevron in this arbitration.

The right to water is not limited to personal consumption; it is also used for sustainable development, for activities such as agriculture. In addition, the water must be safe and therefore free of microorganisms, chemical substances or risk of radiation that constitute a threat to health (CEPAL, 2011). In this case, this human right protection remains a responsibility of the Ecuadorian administration. The victims of these acts of political and judicial corruption should seek that their government find the persons or entities responsible for the environmental damage, but not through acts contrary to law, but through a transparent procedure that guarantees human rights.



## Conclusions

Corruption is considered one of the biggest threats to humanity in both developing and developed countries because it distorts economic growth, lowers foreign direct investment, and decreases productivity on a firm level due to inefficient allocations of contracts. Corruption also impedes the general societal and economic environment because it reduces voluntary contributions to public goods, increases inequality, facilitated emigration of highly skilled people and creates inefficiencies in the sport sector. In conclusion, corruption is a cancer. These considerations not only show the economic drawbacks, but also highlight ethical implications on how society as a whole is affected by corruption.

To conclude this study, corruption allegations in international arbitration have risen and there is no reason to think that this trend will slow in the future. Arbitrators face up allegations of corruption at any arbitral stage. They principally diverge on issues such as what is the proper burden of proof and standard of proof, how far the powers and duties of arbitral tribunals extend, and who is responsible. There is no clear consensus among arbitral tribunals to answers this, but they have adopted positions on these issues that have make it easier to deal with cases where corruption arises. Succeeding these considerations, the following points represent important references when allegations of corruption appear in international arbitration:

[1] Corruption is a violation of, or distortion of, fundamental rules, laws, policies, or exploitation of trust to provide illegal or unauthorized privileges and undue advantages, in exchange for either personal or third party gain, but to the detriment of public interest.

[2] The greatest challenge arbitral tribunals encounter in the face of corruption allegations is to determine the applicable standard of proof that the party with the burden of proof must satisfy.

There are not international rules, national rules, institutional rules or principles that determine a standard of proof. Arbitral tribunals have discretionary authority to establish the standard of proof in each case. In some cases, arbitral tribunals proceeded from the premise that the usual standard is a higher one derived from criminal law. In others, on the contrary, arbitrators applied an ordinary standard derived from civil law. The concept of circumstantial evidence and red flags, however, have been used to determine the existence of corruption or its elements. But the truth is that, nowadays, arbitral tribunals have established that a higher standard of proof is necessary to determine corruption in an arbitral case. It seems that this approach is the most appropriate in arbitration cases where arbitrators are to deal with the issues of corruption due to the gravity of the corruption allegations and its significant legal consequences. Being an arbitrator should not be an easy job to do, however from this perspective, they must be willing during the entire arbitration process to face allegations of corruption from a neutral point of view, willing to help not just establishing an appropriate standard of proof, but also by clarifying the dispute.

[3] Regarding the state liability, corruption defense has emerged as a potent tool for host states to defeat investor claims in cases where the contract in question was obtained through corruption. The drastic and one-sided approach that tribunals have adopted in resolving the corruption issue practically eliminates all equitable considerations in favor of the investor. When the tribunal regards the investment as tainted with corruption, any licit basis for an arbitration proceeding disappears. This not only yields detrimental consequences for the investor who is deprived of full access to investment treaty protection; it also creates a powerful incentive for states to cultivate a culture of corruption in order to escape liability for breach of their obligations towards the investor, or otherwise to profit from their own misconduct. As I

explained above, only in one case, the respondent state was actually sentenced to pay for inducing the investor to corrupt actions, it was the *Spentex v. Uzbekistan* ICSIC Case. A more immediate reaction to host states' corrupt behavior is needed. It is necessary that states cooperate with courts in their fighting against corruption. In addition, considering the whole system of international norms, rules and principles, there should be a list of sanctions on investments in those cases where a state alleges corruption by an investor but the state also was the originator of these corrupt actions.

[4] Bad administrative and judicial practices, and corruption are present in our daily lives. At the same time, we are going through an environmental crisis in which these wrongdoing practices may have irreversible effects when they affect the environment. For this, it is important that the states adopt the protection of the environment as a factor of safeguard and concretization of other fundamental rights. They must adopt measures such as transparency in the accounts and decisions that affect the environment and allow the participation of citizens so that corruption does not permeate the protection of this fundamental right. Combating corruption is everyone's job.

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